

1 DAUFUSKIE ISLAND UTILITY COMPANY, INC.

2 DOCKET NO. 2014-346-W/S

3 Testimony of John F. Guastella

4 On

5 REHEARING

6 Before the South Carolina Public Service Commission

7 Rehearing Testimony Prepared: October 18, 2017

8 Rehearing Date: TBD

9
10 **Q. Please state your name and business address.**

11 A. John F. Guastella, 725 N. Highway A1A, Suite B103, Jupiter, Florida 33477.

12
13 **Q. Did you submit direct and rebuttal testimony in the primary case?**

14 A. Yes, I provided direct testimony, rebuttal testimony, and exhibits in the primary
15 case. I also testified before the Commission at the hearing on October 28, 2015.

16
17 **Q. Do you adopt all of your testimony and the exhibits in their entirety in the
18 primary case as if repeated and submitted herewith?**

19 A. Yes.

20
21 **Q. Have you reviewed South Carolina Supreme Court Opinion No. 27729,
22 reversing and remanding Commission Order No. 2015-846?**

23 A. Yes.

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Q. What is the purpose of your testimony?

A. The purpose of my testimony has not changed from my testimony in the primary case, which is to demonstrate DIUC’s cost of providing adequate water and wastewater service. In the original proceeding, DIUC accepted 19 adjustments to its Application in response to the positions asserted by ORS. However, there were five major ORS adjustments that DIUC could not accept because those five adjustments were not based on the evidence and therefore would deny DIUC enough revenue to cover its known, unavoidable operating expense and prevent DIUC from earning a reasonable return on its actual net investment rate base. This rehearing provides the Commission an opportunity to reconsider the ample and reliable evidence of DIUC’s reasonable cost of providing service. If the Commission enters an order based upon that evidence and accepts DIUC’s position on these five adjustments, the Commission will have established rates for DIUC that provide enough revenue to cover its known, unavoidable operating expenses thereby allowing DIUC to earn a reasonable return on its actual net investment rate base.

Q. Would you briefly summarize the issues DIUC presented to the Supreme Court in its appeal of Order 2015-846?

A. DIUC’s appeal of Order 2015-846 addressed the validity of the Commission’s acceptance of the ORS-Intervenors Settlement Agreement and the Order’s adoption of the five major ORS adjustments. In its appeal, DIUC explained to the

1 Supreme Court why DIUC could not accept those five adjustments and
2 demonstrated that the adjustments were not based on the evidence and therefore
3 would deny DIUC the ability to earn a reasonable return on its actual net
4 investment rate base.

5 **Q. Can you identify the five adjustments DIUC discussed in its appeal?**

6 **A.** Yes. DIUC appealed Order 2015-846's adjustments to utility plant in
7 service, property taxes, bad debts, rate case expenses, and management fees.
8

9 **Q. What is your understanding of the overall impact of the Supreme Court's**
10 **reversal and remand of Order 2015-846?**

11 **A.** The Supreme Court found that the ORS-Intervenors Settlement Agreement should
12 not have been approved by the Commission. The Court found there was no
13 evidence to support Order 2015-846's inclusion of the five major adjustments
14 proposed by ORS then provided what the Court referred to as "guidance to the
15 Commission on remand" regarding three of those five major adjustments.
16 Specifically, the Court addressed utility plant in service as to the elevated storage
17 tank and related facilities, property taxes, and bad debts.
18

19 **Q. Is there specific language in the Supreme Court's order and other factors**
20 **that you rely on for that understanding?**

21 **A.** Yes. Page 8 of the Supreme Court's Opinion states:

22 "...the Settlement Agreement did not resolve *any* issues between the
23 parties, but rather was merely an agreement between the POAs and ORS
24 not to object to one another's pre-filed testimony, and to accept ORS's
25 recommendations and adjustments should the Commission adopt them.

1 Furthermore, the Settlement Agreement contained multiple adjustments
2 which were entirely unsupported by the evidence presented to the
3 Commission. Therefore, we hold that Commission erred in approving
4 and adopting the Settlement Agreement and DIUC is entitled to a new
5 hearing in which the parties may present any additional evidence. While
6 we are reversing and remanding for a new hearing as to all issues, in
7 order to provide guidance to the Commission on remand, we address
8 three allegations of error raised by DIUC in this appeal.”
9

10 Accordingly, in addition to the three specific directions by the Supreme Court
11 regarding the issues of elevated storage tank and related facilities, property taxes,
12 and bad debts, the Supreme Court’s Order rejected Order 2015-846’s adjustments
13 to management fees, rate case expenses, and the portions of utility plant in service
14 that are not related to the elevated storage tank and related facilities.
15

16 **Q. What are the issues and/or adjustments will you address in this testimony?**

17 **A.** As previously stated, I adopt all of my testimony and exhibits in their entirety
18 from the primary case and rely upon the testimony and exhibits of The Hon.
19 Maria Walls, Gary C. White, and Eric Johanson as reflected in the transcript and
20 exhibits of record in this proceeding as if repeated and submitted herewith. With
21 respect to the Supreme Court’s specific directions, DIUC’s position is that:

22 1. No further testimony is necessary at this time to support DIUC’s position
23 regarding rate base treatment of the elevated storage tank and related facilities. The
24 Application’s inclusion of the elevated storage tank and related facilities within
25 utility plant in service is in accord with the Supreme Court’s guidance and should be
26 accepted.

1 2. No further testimony is necessary at this time to support DIUC's
2 position regarding property taxes. The Application's original request for property
3 taxes is in accord with the Supreme Court's guidance and should be accepted.

4 3. No further testimony is necessary at this time to support DIUC's position
5 as to the appropriate allowance for bad debts. The amount for bad debts sought by
6 DIUC is based upon the allowance endorsed by the Supreme Court, with
7 consequential recalculation based upon increased overall revenue, and should be
8 accepted.

9 These adjustments are shown in the "Schedules in Support of Rate Increase
10 Rehearing" submitted in conjunction with the Prefiled Rehearing Testimony of Gary
11 C. White and marked as Exhibit GCW-R1.

12
13 **Q. Does this complete your summary of DIUC's position as to the three major**
14 **adjustments upon which the Supreme Court offered specific direction to the**
15 **Commission on remand?**

16 **A.** Yes.

17
18 **Q. Do you intend to offer testimony as to DIUC's position on the remaining**
19 **issues DIUC raised on appeal regarding Order 2015-846?**

20 **A.** Yes. I will discuss the costs of utility plant in service that are not related to the
21 elevated storage tank facilities, management fees, and rate case expenses.

22

1 **Q. What are your comments regarding the costs of utility plant in service that**
2 **are not related to the elevated storage tank facilities?**

3 **A.** The total ORS adjustment to plant in service adopted by Order 2015-846 was
4 \$1,624,696, but the components of that total were not specified by ORS or the
5 Order. The largest portion apparently related to the elevated storage tank, which
6 the Supreme Court has now, in agreement with DIUC, ruled should be included in
7 DIUC's plant in service. My incorporated rebuttal testimony in the primary case
8 also addresses the reasons why ORS's other adjustments to utility plant in service
9 did not adequately identify the specific items of utility plant and did not provide
10 any basis as to why the costs were not reasonable. Addressing the ORS
11 adjustment's inclusion of items other than the elevated storage tank and related
12 facilities, I testified in detail in rebuttal explaining why all of the costs, account by
13 account, were reasonable and should be included in rate base. My rebuttal
14 testimony was not refuted and supports DIUC's position as to why the
15 Commission should not accept any downward adjustment as to utility plant in
16 service not related to the elevated storage tank facilities.

17
18 **Q. What comments do you have regarding the ORS adjustment for**
19 **management fees?**

20 **A.** This is another adjustment by ORS that my rebuttal testimony thoroughly
21 demonstrated was unreasonable. My extensive rebuttal testimony and related
22 exhibits demonstrating the reasonableness of the management fees were not
23 refuted, and not even addressed by Order 2015-846. Accordingly, the record

1 amply supports DIUC's position as to why the Commission should not accept any
2 downward adjustment to the management fees requested by the Application.

3
4 **Q. What does DIUC propose regarding rate case expenses?**

5 **A.** The Supreme Court's decision in this matter states, "Rate cases are heavily
6 dependent upon factors which are subject to change during the pendency of an
7 appeal, thus it serves no purpose to bind parties to evidence presented at the
8 hearing which may no longer be indicative of the current economic realities on
9 remand." In accordance with that ruling, I submit herewith additional evidence
10 related to DIUC's rate case expenses because this evidence adequately reflects the
11 current economic realities facing DIUC. DIUC proposes the Commission
12 incorporate that evidence into its forthcoming order.

13
14 **Q. Can you begin by summarizing the evidence DIUC presents as to its rate case**
15 **expenses?**

16 Rate case expenses are a necessary cost of operating any utility, but it is essential
17 to note that the cost of a rate case has significant financial impact on a small
18 utility like DIUC. As I testified in the primary case, the rate case procedures and
19 discovery required of DIUC in this matter were equal to those for a large utility.
20 The parties participated in exhaustive discovery prior to the hearing. DIUC was
21 required to respond to in excess of 150 discovery requests (exclusive of multiple
22 subparts), review the direct testimonies of nine witnesses, prepare rebuttal
23 testimony and surrebuttal testimony, and prepare for the hearing on the

1 Application. A larger utility with larger revenue and more staffing would be
2 better equipped to absorb the high costs of extensive discovery and other
3 proceedings, but DIUC cannot. As with the other adjustments, DIUC relies upon
4 and incorporates its previous filings and testimony. At the time of the hearing I
5 estimated that the actual rate case expenses to date were about \$380,000.
6 However, DIUC's Application included only \$191,200 in an effort to mitigate the
7 impact on ratepayers. ORS responded by proposing an even further adjustment
8 that allowed only \$97,500 for rate case expenses. As shown in detail through
9 DIUC's evidence, particularly my unrefuted rebuttal testimony, the rate case
10 expenses incurred were actual, unavoidable, and reasonable in the circumstances.

11

12 **Q. Did DIUC incur additional rate case expenses after the hearing during which**
13 **you testified as to the \$380,000 expended as of that time?**

14 **A.** Yes.

15

16 **Q. Can you explain what happened?**

17 **A.** Yes. Order 2015-846 allowed a rate increase of approximately 43%. If that
18 ruling was accepted without challenge, DIUC would have had no earnings and
19 would have been in default on its debt – essentially bankrupt.

20

21 **Q. How would DIUC have been in default?**

22 **A.** DIUC's loan documents for the SunTrust Bank financing approved by this
23 Commission in Docket No. 2012-397-WS, Order No. 2013-605, include

1 covenants that put DIUC in default if it does not maintain a minimum debt service
2 coverage and minimum EBITDA (i.e., Earnings Before Interest, Taxes,
3 Depreciation, and Amortization) ratio. The lack of income allowed by the Order
4 would have put DIUC in default on its \$2,500,000 term loan and would have
5 precluded DIUC's ability to repay its \$500,000 line of credit. It would have also
6 indefinitely prevented DIUC from attracting additional capital for system
7 improvements that are necessary to meet DHEC requirements. For inclusion in
8 the record, I have attached as Exhibit JFG-1R a copy of the Loan Documents as
9 previously produced to the parties in this case.
10

11 **Q. What happened next?**

12 **A.** We had no choice but to file a motion for reconsideration to ask the Commission
13 to correct the Order. That motion was filed on December 21, 2015, and captioned
14 as DIUC's Petition for Reconsideration and/or Rehearing.
15

16 **Q. Did you prepare any schedules in conjunction with DIUC's Petition for**
17 **Reconsideration and/or Rehearing?**

18 **A.** Yes. I prepared a schedule demonstrating the impact of the Commission's Order
19 on DIUC's operations and how SunTrust would test DIUC's booked cost of
20 operations pursuant to the Loan Documents we had previously produced to ORS
21 and the Intervenors. The Schedule was entitled "Impact of Commission's Order
22 Accepting ORS/POA Settlement" and a copy was filed with DIUC's Petition for

1 Reconsideration and/or Rehearing as Attachment A. For inclusion in the record, I
2 have attached as Exhibit JFG-2R a copy of the Schedule.

3

4 **Q. Can you explain what the Schedule (Exhibit JFG-2R) illustrates?**

5 **A.** Yes. The Schedule shows the \$1,536,375 of combined water and sewer revenues
6 allowed by Order 2015-846 then subtracts the actual cost of operations DIUC will
7 incur and book. The operating expenses of \$1,355,363 listed in the Schedule are
8 those DIUC included in its Proposed Order because SunTrust uses these actual
9 costs and booked figures to perform its tests of Debt Service Coverage and the
10 EBITDA ratio. In other words, when SunTrust analyzes DIUC's books to
11 determine if DIUC is in compliance with the terms of its loan, SunTrust will
12 review the books DIUC presented to the Commission that reflect the Utility's
13 actual expenses and bad debts. SunTrust does not consider reductions or analysis
14 of adjustments like those asserted by ORS or Intervenors in response to a rate
15 application; instead, SunTrust looks at cash flow to test DIUC's compliance with
16 the terms of the SunTrust loan.

17

18 **Q. Can you further explain the Schedule (Exhibit JFG-2R) with some specific**
19 **examples?**

20 **A.** Yes. DIUC's ongoing property taxes are used by SunTrust at the levels that must
21 be accrued in order for DIUC to make its monthly and annual tax payments.
22 However, the Order included ORS's alternatively calculated property tax expense
23 allowance which was considerably less than the actual known and measurable

property taxes that DIUC pays. In addition to covering its actual monthly installment payments under the property tax Settlement Agreement with Beaufort County, SunTrust requires DIUC properly accrue amounts sufficient to satisfy S.C. Department of Revenue assessments and Beaufort County property tax rates. These amounts were not allowed by the Order. Also, SunTrust considers DIUC's obligation to pay management fees according to the GA management contract without regard to the reduction that the ORS-Intervenors Settlement Agreement proposed. Management costs, then, are booked in accordance with the agreement and costs actually incurred. Finally, the bad debt expense used by SunTrust is the booked amount.

Q. Does the Schedule (Exhibit JFG-2R) show anything else?

A. Yes. The Schedule shows the cash flow allowed by Order 2015-846 and demonstrates the calculation which will form the basis of SunTrust's decision as to whether DIUC is in compliance with its loans. Specifically, the Schedule shows the following calculation:

Revenues	\$1,536,375
Operating Expenses	<u>(\$1,355,363)</u>
Net Operating Income	\$ 181,012
Interest Due	<u>(\$ 142,510)</u>
Net Income	\$ 38,501

1 **Q. Is anything else considered by SunTrust in determining whether DIUC is in**
2 **compliance with its loan?**

3 **A.** Yes. SunTrust will include depreciation and debt service. So, using depreciation
4 of \$93,089 and deducting debt service from Net Operating Income, the Schedule
5 demonstrates cash flow under Order 2015-846 would be a negative \$4,024. This
6 is a disastrous result.

7
8 **Q. Why is that a disastrous result?**

9 **A.** Pursuant to the SunTrust loan, DIUC must maintain certain ratios of coverage for
10 debt and EBITDA. These are included on the Schedule and as shown, if DIUC
11 collects only the approved rates under Order 21015-846, then there will be no
12 money for equity return and DIUC will fail SunTrust's tests for debt service
13 coverage and the EBITDA ratio. Accordingly, under the rates approved by the
14 Order, DIUC will be in default on the SunTrust financing, DIUC will not be able
15 to obtain refinancing to pay off its \$500,000 line of credit, and it will not be able
16 to attract capital to make further capital improvements necessary to provide
17 adequate service and comply with DHEC requirements. The SunTrust
18 refinancing is essential to the survival of the Utility.

19
20 **Q. Did the Commission grant the Petition for Reconsideration and/or**
21 **Rehearing?**

22 **A.** No. The Petition was denied, so the Utility had no choice but to pursue an appeal.
23

1 **Q. What impact did the appeal have on rate case expenses for DIUC?**

2 **A.** DIUC's appeal of Order 2015-846 added another layer of significant rate case
3 expense, which continues to grow as the current rehearing process proceeds. In
4 order to survive, DIUC had to put appropriate rates in effect pending appeal. This
5 required DIUC to obtain bonds, which first had to be presented to and approved
6 by the Commission. The bonds later had to be renewed and an additional bond
7 obtained. These efforts cost the Utility significant and unavoidable legal and
8 consulting charges in addition to the cost of bonds. At this point, the cost of
9 actual rate case expenses as of September 30, 2017, including projections to
10 complete the rehearing process for legal and consulting services totals
11 \$794,201.17, plus the \$60,781.56 DIUC incurred for the bonds and an associated
12 letter of credit.

13
14 **Q. Have you prepared a schedule showing by month the legal and consulting**
15 **charges, bond costs, and projected future costs from the initial work to**
16 **prepare and file for the rate increase through anticipated completion of this**
17 **rehearing process?**

18 **A.** Yes. Attached hereto as Exhibit JFG-3R is a schedule of monthly charges
19 incurred by DIUC to prepare and pursue this rate case, plus the cost of the bonds.
20 The schedule includes projected future costs to completes the anticipated
21 rehearing process, assuming there are no further appeals.

22

1 **Q. What are the rate case expenses DIUC proposes for inclusion in the revenue**
2 **requirement?**

3 **A.** DIUC requests that the total rate case expenses for legal and consulting in the
4 amount of \$794,210, plus the \$60,782 of bond costs, be recovered and amortized
5 over 3 years. This total rate case expense adequately reflects the current
6 economic realities facing DIUC.

7
8 **Q. Why are you proposing a 3 year amortization period?**

9 **A.** The Application was filed in June of 2015 and depending on the schedule of the
10 rehearing, final rates will not be billed until January or March of 2018. That is
11 nearly three years after the initial filing. The Commission does not allow
12 unamortized rate case expenses in rate base. Applying a 3 year amortization, on
13 average the recovery of these significant rates case expenses will spread over
14 approximately 5 years. Applying a 5 year amortization would extend the period
15 to 7 years, which is fundamentally unfair to the Utility. Even under a 3 year
16 amortization, which in this instance will actually spread the recovery over a 5 year
17 period, DIUC's owners will have to absorb significant carrying costs, effectively
18 reducing recovery of the full amount of the expense and, therefore, in effect
19 denying the a reasonable opportunity to earn the fully allowed rate of return on
20 equity. The length of this case and appeal combined with the time it will take to
21 recover the expenses indicate a 3 year amortization is the just result.

1 **Q. Why is DIUC seeking to recover the total amount of the rate case expenses,**
2 **as opposed to absorbing a portion as previously discussed?**

3 **A.** First, DIUC's total rate case expenses has reached a magnitude that is far too
4 disproportionate to its revenues. Second, recovery of the expenses will be spread
5 over time by amortization which does not account for the carrying costs or time
6 value of money. It is no longer reasonable to expect DIUC to simply absorb costs
7 of a lengthy proceeding that has mushroomed due to no fault of the Utility. It is
8 also important to note that DIUC's only source of obtaining outside financing,
9 SunTrust Bank, has not been willing to refinance the existing loans and provide
10 needed funds for capital improvements until the final rates are approved in a
11 reasonable amount. SunTrust requires periodic financial statements and has been
12 aware that the Commission's rate order allowing only a 43% rate increase would
13 have placed DIUC in default on the existing loans, and the uncertainty of the
14 outcome of DIUC's appeal of Order 2015-846 has created a risk and hesitation for
15 it to provide financing. In fact, as demonstrated in the email from SunTrust Vice
16 President Carol Coppola attached hereto as Exhibit JFG-4R, SunTrust will offer
17 no additional credit until this rate case is resolved. As I have testified at length in
18 this matter, DIUC desperately needs additional financing for delayed capital
19 improvements. Finally, not only has there never been a dividend paid to any
20 owner since the inception of the DIUC (formerly Haig Point Utility Company),
21 but the existing owners have had to repeatedly infuse significant amounts of
22 capital into DIUC to pay for operational costs during the appeal and before. In
23 addition, the owners are responsible to pay for accounts payable for consulting

1 services that were not paid on a current basis because the priority use of all cash
2 flow has always been to provide adequate service to DIUC's customers. In sum,
3 the Utility's owners cannot reasonably be expected to absorb any further costs and
4 a new rate order reflecting the actual, known rate case is expenses is appropriate.
5

6 **Q. Have you directed Mr. Gary White to prepare the same format of schedules**
7 **as was filed with DIUC's original Application containing the positions you**
8 **explain above?**

9 **A.** Yes, at my direction and supervision, Mr. White has prepared an exhibit entitled
10 "Schedules in Support of Rate Increase Rehearing." I would note that in my
11 rebuttal testimony in the primary case, DIUC accepted 19 adjustments made by
12 ORS. These schedules reflect those adjustments as well as the positions I have
13 discussed herein regarding the Supreme Court's findings.
14

15 **Q. What is the result of your analysis as reflected in this exhibit?**

16 **A.** Taking into account the Supreme Court's decision and reflecting current
17 economic realities following remand as the Utility awaits rehearing, the revenue
18 requirement is \$2,423,049, which is a 125.7% increase over the rates authorized
19 pursuant to the last petition for rate adjustment.
20

21 **Q. How does that compare to the amount originally sought by the Application in**
22 **this case?**

1 **A.** The Application included a revenue requirement of \$2,267,721, which is a
2 108.9% increase over the rates authorized pursuant to the last petition for rate
3 adjustment. The current economic realities facing DIUC indicate a revenue
4 requirement \$155,328 greater than the amount included in the Application
5 (\$2,423,048 less the originally proposed revenue requirement of \$2,267,721).
6

7 **Q.** **How does DIUC propose to address that difference?**

8 **A.** Rather than include the total rate case expenses for legal and consulting in the
9 amount of \$794,210, plus the \$60,782 of bond costs, DIUC requests the
10 Commission enter an order granting the Application's originally proposed
11 revenue requirement of \$2,267,721, resulting in a 108.9% increase, and deferring
12 the \$155,328 difference for future rate recognition.
13

14 **Q.** **Does this complete your testimony at this time?**

15 **A.** Yes.
16

DIUC-ORS 1.77 Attachment A – Loan Covenants



Agreement to Commercial Note

This Agreement dated November 1, 2013, between Daufuskie Island Utility Company, Inc., a South Carolina corporation ("Borrower"), and SunTrust Bank ("SunTrust") constitutes the "Agreement" referenced under "Additional Terms and Conditions" in the Commercial Note from Borrower to SunTrust dated as of the date hereof, in the original principal amount of \$2,750,000.00 and (ii) the Commercial Note from Borrower to SunTrust dated as of the date hereof, in the original principal amount of \$500,000.00 (collectively the "Note"). The term "Loan Amount" shall include all amounts evidenced by the Note. The terms and conditions of this Agreement and the terms and conditions of the Note constitute the entire agreement between Borrower and SunTrust. All defined terms used herein that are not defined herein shall have the meanings ascribed to such terms in the above referenced Note.

Borrower and SunTrust hereby agree to the following terms and conditions:

I. AFFIRMATIVE COVENANTS

A. Financial Information. Borrower shall deliver the following financial information to SunTrust as indicated below:

Borrower's Annual Financial Statement that has been internally prepared and certified by an authorized officer of Borrower. Such Financial Statement shall be prepared on a GAAP (generally accepted accounting principles) basis and shall be delivered to SunTrust within one hundred twenty (120) days after Borrower's fiscal year-end, commencing with the fiscal year ending December 31, 2013. "Financial Statement" shall include at a minimum, a balance sheet, income statement, statement of retained earnings, statement of cash flows, footnotes, appropriate supporting schedules and other information reasonably requested by SunTrust.

Borrower's Federal income tax returns (including all schedules) shall be delivered to SunTrust on an annual basis within one hundred twenty (120) days from filing with the Internal Revenue Service, commencing with the December 31, 2012, Federal income tax returns.

Annual Financial Statement of each guarantor (if any) that is a corporation, limited liability company, partnership or other type of business organization that has been internally prepared and certified by an authorized officer of such guarantor. Such Financial Statement shall be prepared on a GAAP (generally accepted accounting principles) basis and shall be delivered to SunTrust within one hundred twenty (120) days after such guarantor's fiscal year-end, commencing with each such guarantor's fiscal year ending December 31, 2012. "Financial Statement" shall include, at a minimum, a balance sheet, income statement, statement of retained earnings, statement of cash flows, footnotes, appropriate supporting schedules and other information requested by SunTrust.

Federal income tax returns (including all schedules) of each guarantor that is a corporation or other type of business organization shall be delivered to SunTrust on an annual basis within one hundred twenty (120) days from filing with the Internal Revenue Service, commencing with the December 31, 2012 Federal income tax returns.

Personal financial statement, on SunTrust's form, and a current tax return with all schedules, of each individual guarantor or other type of surety shall be delivered to SunTrust annually, within one hundred fifty (150) days after the end of each fiscal year of Borrower, and, in any event no later than twelve (12) months from the last submission of a personal financial statement from each individual guarantor.

Borrower shall deliver within five (5) days of such request, any additional financial information with respect to Borrower or any guarantor as SunTrust may reasonably request.

B. Compliance Certificate. Concurrently with the delivery of Borrower's Annual Financial Statement (and also concurrently with the delivery of Borrower's Federal income tax returns) required hereunder, Borrower shall deliver to SunTrust a certificate of a duly authorized officer of Borrower in a form satisfactory to SunTrust (i) certifying as to whether there exists an event of default or any circumstances which, with notice or the passage of time or both, would constitute an event of default and if there exists an event of default or any such circumstance, specifying the details thereof and the action which Borrower has taken or proposes to take with respect thereto and (ii) setting forth in reasonable detail calculations demonstrating compliance with the financial covenants included in this Agreement.

C. Notification. Borrower shall immediately notify SunTrust of (i) the occurrence of any event of default (or any circumstances which, with notice or the passage of time or both, would constitute an event of default) under the Note, (ii) the commencement

of any action, suit, or proceeding or any other matter that could reasonably be expected to have a material adverse effect on the financial condition, operations, assets or prospects of Borrower, (iii) any event or development that could reasonably be expected to have a material adverse effect on the assets, operations or financial condition of Borrower and (iv) any change in the senior management of Borrower.

- D. **Deposit Accounts.** Borrower shall maintain its primary operating account with SunTrust.
- E. **Loan Documentation and Additional Requirements.** All required documentation, including but not limited to Commercial Note(s) and Addendum(s) thereto, Mortgage(s), Security Agreement(s), borrowing resolutions, Unconditional Guaranty(s), Borrower's proposed capital improvement cost schedule and budget, and any and all other documents required by SunTrust for closing, shall be delivered to SunTrust in form and substance satisfactory to SunTrust.
- F. **Capital Fund Account.** Loan proceeds in the amount of \$750,000 shall be deposited in a separate and exclusive capital fund account maintained at SunTrust to be used solely for funding the capital improvement costs of Borrower, subject to the reasonable approval of SunTrust.

II. NEGATIVE COVENANTS

- A. **Liens.** Borrower shall not, and shall not permit any Subsidiary (if any) to, create, incur, assume or permit any lien, security interest or other type of encumbrance (a "Lien") on any of its assets, except Liens granted to SunTrust, statutory Liens that do not secure indebtedness and other Liens that have been consented to by SunTrust in writing.
- B. **Additional Indebtedness.** Borrower shall not, and shall not permit any Subsidiary (if any) to, create, incur, assume or permit any indebtedness for money borrowed, reimbursement obligations under letters of credit, capital lease obligations or hedging obligations (collectively, "Indebtedness") or any guarantees or endorsements of any Indebtedness, other than Indebtedness to SunTrust without written permission of SunTrust.
- C. **Dividend Payments.** Upon the occurrence and during the continuation of an Event of Default or any event or condition that with the passage of time or the giving of notice or both could become an Event of Default, Borrower will not declare or make, or agree to pay or make, directly or indirectly, any cash dividend on any class of its stock.
- D. **No Change in Ownership.** Borrower shall not, and Daufuskie Island Holding Company, LLC shall not have a change in ownership without written permission of SunTrust.

III. FINANCIAL COVENANTS

So long as any portion of the Loan Amount under the Note remains unpaid and in the case of an open-end revolving borrowing arrangement, the Loan Amount remains available for advances, Borrower covenants and agrees as follows (unless otherwise indicated, all accounting terms used in the following financial covenants shall be construed in conformity with generally accepted accounting principles in the U.S. as in effect from time to time):

A. Debt Service Coverage Ratio

The Debt Service Coverage Ratio of the Borrower shall not at the end of each fiscal year be less than 1.20 to 1.0.

"*Debt Service Coverage Ratio*" means the ratio of EBITDA less distributions divided by Debt Service.

The following definitions apply to the determination of Debt Service Coverage Ratio:

"*EBITDA*" means net income plus Interest Expense income tax expense, depreciation expense and amortization expense determined for such fiscal year.

"*Debt Service*" means the sum of (a) all scheduled principal payments due by Borrower on Funded Debt plus (b) Interest Expense, each determined for such fiscal year.

"*Funded Debt*" means (1) all obligations for money borrowed, (2) all obligations evidenced by a bond, indenture, note, letter of credit or similar instrument, (3) all obligations under capital leases and (4) all other obligations upon which interest charges are customarily paid.

"*Interest Expense*" means interest expense (including without limitation the interest component of any payments in respect of capital leases capitalized or expensed during such period) determined for such fiscal year.

B. Excess Cash Flow Recapture

One-half (1/2) of the Free Cash Flow (as defined below) generated during each fiscal year will be used by Borrower to reduce the outstanding loan balance or, at the election of Borrower, placed into a sinking fund account with SunTrust. The accumulated free cash flow recaptured will be capped at \$1,000,000.00. This recapture transaction will occur annually, and no later than May 31st of each calendar year, and with the first reduction to be received no later than May 31, 2014. Any change in the fiscal year end of the Borrower would require this covenant to be re-set such that the timing of the payment meets the requirements of SunTrust in its sole discretion.

The following definitions apply to the determination of Excess Cash Flow Recapture:

"*Capital Expenditures*" means all additions (Column C) for each fiscal year as detailed in Schedule 201 Utility Plant in service for the combined statements for the Water Utility Annual Report of Borrower and the Wastewater Utility Annual Report of Borrower/Melrose WWTP.

"*Free Cash Flow*" means EBIDA less debt service and Capital Expenditures determined for such fiscal year.

"*EBIDA*" means net income plus Interest Expense, depreciation expense and amortization expense each determined for such fiscal year.

"*Interest Expense*" means interest expense (including without limitation the interest component of any payments in respect of capital leases capitalized or expensed during such period) determined for such fiscal year.

IV. CONDITION PRECEDENT TO THE MAKING OF EACH ADVANCE

- A. The making of each advance under the Note is subject to accuracy of representations and warranties and the further condition that no Event of Default or event which with the passing of time or the giving of notice or both would constitute an Event of Default shall exist at such time.
- B. With regard to Advances requested by Borrower under the Commercial note in the amount of \$500,000 (the "Line of Credit Note"), the following requirements shall apply to each Advance:
Borrower shall submit for review and approval by SunTrust copies of the purchase orders or invoices, which purchase orders or invoices must be for capital expenditures reasonably necessary for Borrower's business.

V. ADDITIONAL EVENTS OF DEFAULT

- A. Any guarantor terminates or cancels or seeks to terminate or cancel its Guaranty.
- B. Failure of Borrower on or before November 1, 2015, to re-acquire that certain water tank and well site depicted on the plat attached hereto as Exhibit A and pledge Borrower's interest in said property by executing and delivering the following:
 - (1) a Mortgage in form and substance satisfactory to SunTrust; and
 - (2) an endorsement to SunTrust's title insurance policy which insures title to said property, subject only to such encumbrances and exceptions as are reasonably satisfactory to SunTrust; provided, however, that Borrower shall also provide DHEC's confirmation that the improvements, structures and diesel tank on this property do not violate the restrictions, covenants or agreements referenced in Deed Book 2298, Page 2090, Beaufort County records.

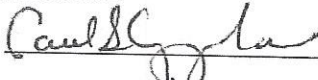
IN WITNESS WHEREOF, Borrower and SunTrust have caused this Agreement to be executed as of the date first above written.

Daufuskie Island Utility Company, Inc.,
a South Carolina corporation

By 
Terry R. Lee, its President

[SEAL]

SunTrust Bank

By: 

CAROL COPPOLA VP
Name and title

EXHIBIT A

ATTACHMENT A**Impact of Commission's Order
Accepting ORS/POA Settlement**

		PSC Revenue Allowance
REVENUES		
Operating Revenues-Water		\$821,375
Operating Revenues-Sewer		715,000
Total Revenues		<u>\$1,536,375</u>
OPERATING EXPENSES		
O & M Expenses		\$906,611
Rate Case Expense		47,800
Depreciation	b	93,089
Payroll Tax		13,212
Property Tax		258,227
Other Taxes		13,520
Income Taxes		22,904
Total Operating Deductions		<u>\$1,355,363</u>
Net Operating Income	a	\$181,012
Interest Expense		<u>142,510</u>
NET INCOME		<u><u>\$38,501</u></u>
DEBT SERVICE		
\$2.75 Million Term Loan		\$265,974
\$500,000 Line-of-Credit		12,150
	c	<u>\$278,124</u>
CASH FLOW	a+b-c	<u><u>(\$4,024)</u></u>

SunTrust Bank - Loan Requirements

\$2.75M Note

Debt Service Coverage:

Net Income + Deprec + Amort + Interest		\$274,101
Principal & Interest		\$265,974
Coverage Ratio	<div style="border: 1px solid black; padding: 2px;">>1.50</div>	1.03
	Passed Test	NO

EBITDA Ratio:

NOI + IT + Deprec + Amort		\$297,005
Total Debt		\$2,750,000
Ratio	<div style="border: 1px solid black; padding: 2px;">< 6.00</div>	9.26
	Passed Test	NO

DIUC						
		Rate Case Expense From June 2014 Through August 2017				
		Pending Rate Case				
			Amount			
		Month/Year	GA LLC	PTW/WGFL		Total
	1	Jun. 2014	\$ 1,612.50			\$ 1,612.50
	2	Aug. 2014	16,687.50			16,687.50
	3	Sept. 2014	5,130.00	313.98		5,443.98
	4	Oct. 2014	13,122.50			13,122.50
	5	Nov. 2014	14,600.00			14,600.00
	6	Dec. 2014	19,932.50			19,932.50
	7	Jan. 2015	25,239.02	116.44		25,355.46
	8	Feb. 2015	15,692.50			15,692.50
	9	Mar. 2015	4,792.50			4,792.50
	10	Apr. 2015	17,992.50			17,992.50
	11	May. 2015	19,067.48			19,067.48
	12	June. 2015	53,810.00	6,420.50		60,230.50
	13	July. 2015	67,860.00			67,860.00
	14	Aug. 2015		9,544.98		9,544.98
	15	Sept. 2015	19,870.00	6,382.60		26,252.60
	16	Oct. 2015	82,695.50	-		82,695.50
	17	Nov. 2015	37,812.50	12,847.64		50,660.14
	18	Dec. 2015	17,412.50	7,059.58		24,472.08
	19	Jan. 2016	14,652.50	-		14,652.50
	20	Feb. 2016	3,772.00	5,295.00		9,067.00
	21	Mar. 2016	-	1,213.00		1,213.00
	22	Apr. 2016	5,562.50	382.00		5,944.50
	23	May. 2016	8,522.50	6,284.00		14,806.50
	24	Jun. 2016	5,617.50	12,433.00		18,050.50
	25	Jul. 2016	2,537.50	140.00		2,677.50
	26	Aug. 2016	15,357.50	15,970.00		31,327.50
	27	Sep. 2016	-	1,238.00		1,238.00
	28	Oct. 2016	1,307.50	4,524.22		5,831.72
	29	Nov. 2016	-	192.50		192.50
	30	Dec. 2016	22,117.50	15,639.33		37,756.83
	31	Jan. 2017	-	-		-
	32	Feb. 2017	-	3,905.65		3,905.65
	33	Mar. 2017	-	35.00		35.00
	34	Apr. 2017	-	-		-
	35	May. 2017	-	2,985.00		2,985.00
	36	Jun. 2017	7,825.00	2,040.00		9,865.00
	37	Jul. 2017	2,325.00	1,435.00		3,760.00
	38	Aug. 2017	9,700.00	3,740.00		13,440.00
	39	Sep. 2017	10,351.25	11,095.00		21,446.25
		Total	\$ 542,977.75	\$ 131,232.42		\$ 674,210.17
		Total to PSC Decision on 12-8-2015	\$ 415,917.00	\$ 35,626.14		\$ 451,543.14
		Post PSC Decision From				
		Dec. 2015 - September 2017	\$ 127,060.75	\$ 95,606.28		\$ 222,667.03
		Estimate to Complete Rehearing	\$ 60,000.00	\$ 60,000.00		\$ 120,000.00
		TOTAL	\$ 602,977.75	\$ 191,232.42		\$ 794,210.17
		Bond Costs				\$ 60,781.56

From: Coppola.Carol [mailto:Carol.Coppola@SunTrust.com]
Sent: Monday, October 16, 2017 11:26 AM
To: John Guastella <jfg@guastella.com>
Cc: Kutcher.Emily.A <Emily.A.Kutcher@SunTrust.com>
Subject: RE: DIUC - Another LOC

John, we really need an answer on the outstanding billing rates from the commission before we extend any additional credit to Daufuskie Island Water Co. It is difficult to complete our files without the outstanding uncertainties.

Carol Coppola | FVP, Commercial Banking | SunTrust Bank, Savannah Region | 33 Bull Street
 Savannah, GA 31401 | Office: 912-944-1196 | Cell: 912-308-4377 | Fax: 912-238-1135 |

From: John Guastella [mailto:jfg@guastella.com]
Sent: Friday, October 13, 2017 1:14 PM
To: Coppola.Carol
Cc: Kutcher.Emily.A
Subject: DIUC - Another LOC

Hi Carol,

The PSC will conduct a rehearing in response to the Supreme Court's decision rejecting the PSC's 43% rate increase order. Early indications are that the revised rate increase will significantly exceed 84% as compared to the 43% allowed in the PSC's original order. That rehearing and PSC decision, however, will not be completed until after January 1, 2018 so that we would again bill at the 108.9% original rate increase on January 1st, and again be subject to refund as well as extending the existing bonds (\$1,203,595) and adding another \$430,042 bond to cover the first quarter of 2018.

You recall that the bond company required a letter of credit in order to renew and add to the previous bonding, for which SunTrust provided a \$650,000 LOC, a little more than half of the total amount of the bond renewals. As I recall, SunTrust only provided the LOC because of Terry Lee's assistance, but would not do so on the strength of DIUC's own rate and financial circumstances. The renewal and additional bonds for the first quarter of 2018 will be \$1,623,637 which would likely require about an \$850,000 LOC, if the bond company would renew the bond at all. Assuming the bond company will renew the bonds again, would SunTrust be willing to provide a LOC without Terry Lee's assistance?

I am working on a plan to expedite the PSC's process and avoid the need for a bond renewal, but that effort would include whether DIUC can obtain a bond renewal. So, am taking the liberty of asking

for your response ASAP.

Thanks,
John

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[ST:XCL]